IN THE

Supreme Court of the United States

FILED
MAY 16 1942
CLERK

OCTOBER TERM, 1941.

No. 1239

FIFTH STREET BUILDING, a corporation,

Appellant,

vs.

CHARLES J. McCOLGAN, as Franchise Tax Commissioner of the State of California,

Appellee.

APPELLANT'S BRIEF

In Opposition to Appellee's Motion to Dismiss or Affirm and Statement Opposing Jurisdiction, and Statement in Opposition to Granting Writ of Certiorari.

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SUBJECT INDEX.

PAGE

Statement of facts 1

Argument 4

Answering the statement in opposition to granting writ of certiorari 12

TABLE OF AUTHORITIES CITED.

CASES. **PAGE**

Boteler v. Ingels, 308 U. S. 57, 84 L. ed. 78..... 12

Continental Candy Co., In re, 291 Fed. 773..... 13

Educational Films Corp. v. Ward, 282 U. S. 379, 75 L. ed. 400 8

Filoli, Inc. v. Johnson, 4 Cal. (2d) 662..... 8

Fullerton Oil Co. v. Johnson, 2 Cal. (2d) 162..... 8

Palmer v. Massachusetts, 308 U. S. 79, 84 L. ed. 93..... 11

Palmer v. Webster and Atlas Nat. Bank, 312 U. S. 156.....10, 12

Reinicke v. Gardner, 277 U. S. 239, 72 L. ed. 866..... 13

State Tax Commission of Utah v. Van Cott, 306 U. S. 511, 83 L. Ed. 950..... 7

The Pacific Co., Ltd. v. Johnson, 212 Cal. 148, 298 Pac. 489....7, 8

Thompson v. State of Louisiana, 98 Fed. (2d) 108..... 12

United States v. Whitridge, 231 U. S. 144, 58 L. ed. 159..... 13

STATUTES.

Act of Congress of the United States, June 18, 1934 (28 U. S. C., Sec. 124(a))..... 5, 6, 10

Bankruptcy Act, Sec. 77 (11 U. S. C. 205)..... 12

General Laws of California, Act 8488, Sec. 4, Subsec. (3)..... 9

Statutes of California of 1929, Chap. 13..... 2

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Statement of Facts.

On December 30, 1934, Walker's, Inc., a California corporation, filed a voluntary petition in bankruptcy in the District Court of the United States, Southern District of California, Central Division, and was thereupon adjudged a bankrupt. Thereafter, Wm. H. Moore, Jr., was duly appointed trustee in said bankruptcy estate, and remained said trustee during the period in controversy herein.

During the period in controversy herein, said trustee in bankruptcy, under authority of the aforesaid District Court, carried on the business theretofore conducted by the bankrupt corporation.

On March 9, 1937, the said trustee in bankruptcy filed a corporation franchise tax return under the provisions of Chapter 13 of the Statutes of California of 1929, known as the Bank and Corporation Franchise Tax Act, and paid franchise tax for the year 1937 in the amount of $4,764.17.

The bankrupt corporation, Walker's, Inc., was duly discharged by the bankruptcy court in the year 1936, and during the period in controversy herein was privileged to and did exercise its franchise as a corporation separate and independent from any business carried on by the aforesaid trustee in bankruptcy. Said trustee in bankruptcy did not operate any business under the franchise granted by the State of California to Walker's, Inc. Said business was carried on by said trustee under and by virtue of the authority granted by the aforesaid District Court, and under and by virtue of the bankruptcy laws of the United States of America.

The aforesaid trustee in bankruptcy duly filed a claim for refund of said 1937 franchise tax, which was denied.

Fifth Street Building, appellant herein, by order of the Federal Court, became the assignee of the claim for refund, and the owner of any right to a refund of the franchise tax paid by the trustee.

The appellant herein, as plaintiff, brought suit in the Superior Court of the state of California, in and for the county of Los Angeles, for the recovery of the franchise tax paid by said trustee. The appellee herein, as defendant, in said Superior Court, demurred to plaintiff's complaint. Defendant's demurrer was overruled and defendant answered. Defendant, in his answer, did not deny any of the material allegations in the complaint. Thereafter, motions for judgment on the pleadings were filed by both plaintiff and defendant, and thereafter judgment was rendered and entered in favor of the plaintiff and against the defendant for the refund of the aforesaid franchise tax.

Thereafter, appellee herein, as appellant, appealed from the judgment of said Superior Court to the Supreme Court of the state of California. Thereafter said Supreme Court reversed the said judgment of said Superior Court and made and entered its judgment in favor of said appellant, appellee herein, and against the respondent, appellant herein, for the amount of said franchise tax.

Thereafter said respondent, appellant herein, petitioned said Supreme Court for a rehearing, which was denied.

Thereafter, said appellant petitioned the Supreme Court of the state of California for its order granting an appeal to the Supreme Court of the United States, which petition was granted by the Chief Justice of said Supreme Court of the state of California.

ARGUMENT.

Appellee bases his motion to dismiss this appeal or to affirm the judgment below upon the following ground, to-wit: That "*the constitutional power of Congress to prescribe duties and obligations of trustees in bankruptcy, have been so thoroughly foreclosed by previous decisions of this court and other federal courts as to leave no debatable ground for attacking the decision of the Supreme Court of California, and therefore the questions presented are unsubstantial.*" (Italics ours.)

The constitutional power of Congress to prescribe duties and obligations of trustees in bankruptcy has not, in this action, been, and is not now questioned. No question as to the constitutionality of such power in Congress has been made, or is, an issue in this case.

Appellee, having thus based his said motion upon a non-existent ground and upon a question which is not, and which has not at any time been, an issue in this case, his motion should be denied.

Appellee, however, presents an argument in support of his motion which is based upon grounds and questions other than the ground and question upon which he has specifically based his motion.

Appellee's argument in support of his motion, with the exceptions herein mentioned, goes to the merits of the case and not to the question of right to appeal or to the jurisdiction of this court to entertain the appeal of this case from the Supreme Court of the state of California. He cites no authority on the question of the right to appeal or on the question of the jurisdiction of this court to entertain this appeal; nor does he point out wherein the authorities cited by appellant in support of this appeal do not support the right of appeal in this case.

The Act of Congress of the United States of June 18, 1934, 28 U. S. C., Sec. 124(a), which appellant contends was misconstrued by the Supreme Court of the state of California in placing its improper construction upon the California Bank and Corporation Franchise Tax Act, insofar as it is pertinent to this case, reads as follows:

> "Any * * * trustee, * * * appointed by any United States Court who is authorized by said Court to conduct any business, shall from and after June 18, 1934, be subject to all State and local taxes applicable to such business the same as if such business were conducted by an individual or corporation."

In his brief, appellee, after quoting from Sec. 124(a) of Title 28, U. S. Codes, states:

> "It is clear that the effect of this statute is not to impose a state tax but to withdraw restrictions theretofore thought to have been placed by the Bankruptcy Act on State power to tax."

And again:

> "The section merely removes a bar theretofore thought to have been placed by Congress itself on the exercise by the States of their reserved powers."

This admission is directly contrary to the decision of the California Supreme Court in this case.

We agree with appellee that Section 124(a) of Title 28, U. S. Codes, does not impose a tax and we also contend that this section does not affirmatively create a corporation out of a trustee, nor does it tax a trustee in bankruptcy for use of the corporation franchise which, by the provisions of the bankruptcy law does not pass to the

trustee, but remains with the bankrupt, as the facts in this case show.

The Supreme Court admits that the California Bank and Corporation Franchise Tax Act does not impose the tax in controversy. It says:

> "There is no need to amend the Bank and Corporation Franchise Tax Act to specify that a trustee in bankruptcy conducting the business of a corporation shall be subject to the tax *as if he were a corporation* in order to insure that an intervening bankruptcy will not interrupt the application of the tax. * * * The Act of Congress already provides that state taxes are as applicable to such a business *as if it were conducted by a corporation,* and thus *gives to the trustee the status of a corporation for the purpose of the tax.* That status is determined by Congress in the exercise of its plenary authority over the administration of a bankrupt's estate. * * *. Congress creates the trusteeship, fixes the conditions of its existence and may provide, as in the Act of 1934, that a trustee be regarded as of such a nature as to come within the range of state tax law." (Italics ours.)

The decision erroneously holds in simple language:

The state law does not impose the franchise tax on a trustee. The Act of Congress (Act of 1934) (28 U. S. C. 124(a)), affirmatively gives a trustee in bankruptcy the status of a corporation for the purpose of the franchise tax, and imposes a tax on the trustee as if he were a corporation.

By thus intermingling the incorrect construction of the Act of Congress with the State Statute, the Court holds the tax to be due.

The State Court alternatively based its decision upon the State Statute and upon the Federal Statute. These two are so interwoven that it is impossible to conclude that the judgment rests upon an independent interpretation of the state law. The decision rests upon an inseparable intermingling of the federal and state laws. The decision is therefore properly subject to appeal.

State Tax Commission of Utah v. Van Cott, 306 U. S. 511, 514, 83 L. Ed. 950, 952.

The facts, which are not in controversy, disclose that Walker's Inc., was adjudicated a bankrupt December 30, 1934, and was discharged from bankruptcy in 1936, and that during the entire period in controversy did exercise its franchise separate and independent from any business carried on by the trustee.

Appellee admits that "the tax herein involved was not measured in any part by any income derived by the discharged corporation from the use of that franchise."

The undisputed facts also show that the trustee in bankruptcy did not operate any business under the franchise of the corporation.

The Supreme Court of California, by the construction placed upon the federal law in this case, holds the trustee liable for the corporation franchise tax, by reason of the provisions of the federal law. The construction placed upon the state law by the Supreme Court of California and the Supreme Court of the United States in other cases, holds the bankrupt corporation liable for the franchise tax because it retains the franchise and continues to exist and operate only by reason of the franchise.

The Pacific Co., Ltd. v. Johnson, 212 Cal. 148, 154-5, 298 Pac. 489, 492.

The judgment of the Supreme Court of California, above cited, was affirmed by the Supreme Court of the United States, wherein was used the following language:

> "This distinction, so often and consistently reaffirmed, is but a recognition that the franchise, the privilege of doing business in corporate form, which is a legitimate subject of taxation, does not cease to be such because it is exercised in the acquisition and enjoyment of non-taxables. The distinction is one of substance, not of form, and has been so recently discussed in *Educational Films Corp. v. Ward* that it need not be elaborated here. It suffices to say that the tax immunity extended to property *qua* property does not embrace a special privilege, the corporate franchise, otherwise taxable, merely because the value of the corporate property or net income is included in an equitable measure of the enjoyment of the privilege. The owner may enjoy his exempt property free of tax, but if he asks and receives from the state the benefit of a taxable privilege as the implement of that enjoyment, he must bear the burden of the tax which the state exacts as its price."
>
> *Pacific Company, Ltd., v. Johnson*, 285 U. S. 480, 490, 76 L. Ed. 893, 896-7.

> "It is a tax for the privilege of exercising a corporate franchise."
>
> *Fullerton Oil Co. v. Johnson*, 2 Cal. (2d) 162, 176;
>
> *Filoli, Inc. v. Johnson*, 4 Cal. (2d) 662, 664.

To the same effect, see also:

> *Educational Films Corp. v. Ward*, 282 U. S. 379, 388, 75 L. ed. 400, 404-5.

There are, therefore, two entities held by the Supreme Court of the state of California to be subject to the franchise tax on the same franchise, *i. e.*, the corporation and the trustee of the bankrupt estate.

The California Bank and Corporation Franchise Tax, General Laws of California, Act 8488, Section 4, Subsection (3) reads as follows:

> "(3) CORPORATIONS OTHER THAN FINANCIAL DOING BUSINESS IN THIS STATE TO PAY TAX. MINIMUM TAX. With the exception of financial corporations, every corporation doing business within the limits of this State and not expressly exempted from taxation by the provisions of the Constitution of this State or by this act, shall annually pay to the State, *for the privilege of exercising its corporate franchises within this State*, a tax according to or measured by its net income, to be computed, in the manner hereinafter provided at the rate of four per centum upon the basis of its net income for the next preceding fiscal or calendar year. In any event, each such corporation shall pay annually to the State, for the said privilege, a minimum tax of twenty-five dollars." (Italics ours.)
>
> Act 8488, Sec. 4, Subsec. (3).

If this Court feels that a consideration of the merits is necessary at this time and that the entire record should be examined, it is respectfully submitted that all of the cases cited by the appellee or by the State Supreme Court are reviewed and the authorities to the contrary are set forth in the Appellant's Petition for Rehearing in the Supreme Court of California, which Petition is a part of the transcript herein.

Appellee quotes one sentence from *Palmer v. Webster and Atlas Nat. Bank*, 312 U. S. 156, a case under Section 77 of the Bankruptcy Act, as follows:

> "What Congress intended was that a business *in receivership*, or conducted under court order, should be subject to the same tax liability as the owner would have been if in possession and operating the enterprise." (Italics ours.)

He then adds:

> "Certainly this statement cannot be reconciled with appellant's theory."

Respondent failed to quote the next sentence in the decision, which reads:

> "In the light of this purpose, the Act does not impose upon the New Haven trustees the obligation to pay taxes arising out of the conduct of the business of Old Colony or Boston and Providence."
>
> *Palmer v. Webster and Atlas Nat. Bank*, 312 U. S. 156, 163; 85 L. ed. 642, 648.

By direct analogy to the present case the Federal Act (28 U. S. C. 124(a)), does not impose upon a trustee in bankruptcy the obligation to pay a franchise tax arising out of the use by the bankrupt corporation of its corporate franchise, which it retained and used outside of bankruptcy and to which franchise the trustee did not have title and which he did not use.

The theory under which the intent of Congress is attempted to be read into the state law is directly contrary to the decision of this Court in *Palmer v. Massachusetts*, 308 U. S. 79, 83, 84 L. ed. 93, 97.

In the last paragraph of the Argument for Dismissal of the Appeal (p. 5, lines 10 to 15, typewritten draft) appellee makes a statement as to what the contentions of the appellant are, as follows:

> "Appellant also argues that the California Bank and Corporation Franchise Tax Act as construed by the California Supreme Court is unconstitutional because it invades the reserved powers of the States and because it imposes a Federal tax for the benefit of California. Undoubtedly appellant made this argument inadvertently, as it is erroneous on its face."

This statement is incorrect. Neither the Supreme Court nor the appellant have anywhere stated that the California law imposes a federal tax.

The Supreme Court of California held that the federal law, imposed a state tax.

Appellant contends that the construction of the federal law by the California Supreme Court holding that the federal law imposes the state tax is a misconstruction of the federal law, and that such misconstruction, if read into the California law, is in violation of the Constitution of the United States, in that Congress cannot impose a tax for the benefit of the state.

Answering the Statement in Opposition to Granting Writ of Certiorari.

Appellee states two grounds for his opposition, both of which are based on his statement that the California Supreme Court decision is in accord with decisions of the Circuit Court and of this Court.

Three cases are cited as follows:

Thompson v. State of Louisiana, 98 Fed. (2d) 108.

This was a case of a trustee appointed under Section 77 of the Bankruptcy Act (11 U. S. C. 205).

The Court held that it was the duty of the trustee, and he was required by the Court, to protect the corporate franchise and he was, therefore, liable for the franchise tax. (98 Fed. (2d) 110.) This decision does not support appellee.

Boteler v. Ingels, 308 U. S. 57, 84 L. ed. 78.

This case is one where a trustee in bankruptcy operated vehicles; which act was subject to a tax in California.

The Court held that the trustee was subject to penalties for violation of the state law, the same as any other person operating vehicles.

There is nothing whatsoever in the case which is in point on the question of jurisdiction or on the issues in this case.

Lastly he cites:

Palmer v. Webster and Atlas Nat. Bank, 312 U. S. 156, 85 L. ed. 642.

We have quoted from this decision at p. 10, *supra,* and have shown that the decision does not support appellee's contention.

The decision of the California Supreme Court is in conflict with the cases cited, as well as the following:

U. S. v. Whitridge, 231 U. S. 144, 58 L. ed. 159;

Reinicke v. Gardner, 277 U. S. 239, 242, 72 L. ed. 866, 867;

In re Continental Candy Co., 291 Fed. 773,

and other cases cited in appellant's "Petition for Rehearing Before the State Supreme Court."

It is respectfully submitted that the motion of appellee should be denied and that this appeal be granted or, if the Court feels that this case should more properly be considered on a Writ of Certiorari, as suggested by appellee, then the appellant respectfully requests that said Writ be issued.

Respectfully submitted,

CLARK J. MILLIRON,

Attorney for Appellant.

Due service of the within brief is hereby acknowledged this.....day of April, A. D. 1942.

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Attorneys for Appellee.

4-17-42—65